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SUBJECT: RUSSIAN ENERGY: CPC EXPANSION IN THE WORKS

Classified By: Econ M/C Pamela Quanrud. Reasons 1.4 (b/d).

1. (C) Summary. In a May 10 press conference in Astana, President Putin told the press that he considered the expansion of the Caspian Pipeline Consortium (CPC) "possible," while President Nazarbayev said that additional oil shipments through CPC (the capacity of which would rise by 17 million tons annually) could be delivered through the proposed Burgas-Alexandropolous (B-A) by-pass. Ian MacDonald, head of Chevron's operations in Russia, told us May 14 that Chevron welcomed the presidents' remarks, even though the 17 million ton added capacity is only half the long planned 35 million ton expansion. While not yet a done deal, this signal from the presidents on partial CPC expansion is welcome news. End summary.

2. (SBU) President Putin met with his Kazakh counterpart Nazarbayev in Astana May 10 and discussed CPC expansion as part of a wider dialogue on Russia-Kazakhstan economic cooperation. Their comments during the joint press conference could represent a major breakthrough in stalled CPC expansion plans.

3. (SBU) Chevron's MacDonald tells us the proposed 17 million ton ramp-up is generally consistent with the early phase of its long-planned expansion, and can be added by building more tank storage and adding a few pump stations. Chevron believes, and statements by Putin and Nazarbayev reflect, that the GOR has inextricably tied CPC expansion to the construction of the B-A by-pass. Chevron admits that partial expansion is not yet a done deal, however, as it still needs to negotiate terms with Transneft (which takes control of the GOR's 24 percent equity in CPC in June and is also coordinating the B-A pipeline), and some western CPC shareholders may want to discuss further the proposed size of expansion.

4. (C) Transneft and Rosneft contacts told us May 14 that no official decision on CPC expansion has been made and it is still too early to talk about concrete decisions. Chevron believes that Transneft's response may be a negotiating ploy or a means to buy time while it secures the GOR stake in CPC and maneuvers its own people into CPC leadership positions.

5. (C) Comment: Partial expansion, though not a done deal, would clearly be good news. Coming on the heels of a happy outcome of CPC's tax case (the higher court recently overturned two lower courts' rulings in favor of tax

prosecutors), expansion would go some ways towards making CPC profitable, moving more Kazakhstani oil to global markets, and making the B-A bypass viable.

16. (C) Comment continued: But why 17 million tons? Chevron suspects that this volume was chosen because it is equivalent to about half the capacity slated for B-A and equivalent to the non-Russian volume foreseen for B-A. That Russia probably intends to use some Kazakhstani oil to fill the early stages of its East Siberia-Pacific Ocean (ESPO) pipeline may also stand behind Russian reticence to commit to the total CPC expansion package. Next steps are likely to be negotiations about expansion with Transneft, internal CPC negotiations among shareholders, and Chevron's talks with Bulgaria, Greece, and Russia about committing to B-A.
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